

## Message Text

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ACTION EUR-25

INFO OCT-01 EA-11 ADP-00 AID-20 EB-11 NSC-10 RSC-01

CIEP-02 SS-15 STR-08 OMB-01 CEA-02 CIAE-00 COME-00

FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06 SIL-01

L-03 H-03 PA-03 PRS-01 USIA-15 FS-01 ABF-01 AGR-20

RSR-01 /193 W

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R 201804Z JUL 73

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 2803

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

USMISSION EC BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

USMISSION OECD PARIS

AMEMBASSY ROME

AMEMBASSY STOCKHOLM

AMEMBASSY THE HAGUE

AMEMBASSY TOKYO

TREASURY DEPT WASHDC

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DEPARTMENT FOR FRB

E.O. 11652: N/A

TAGS: PINT, EFIN, UK

SUBJECT: THE POLITICS OF INFLATION

BEGIN SUMMARY: A MAJOR DEBATE ON INFLATION HAS HIGH-  
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LIGHTED THE ECONOMIC POLICY DIFFICULTIES FACING THE

HEATH GOVERNMENT. IN THE RUN-UP TO THE NEXT GENERAL ELECTION, IT WILL HAVE TO GAIN WIDER POPULAR SYMPATHY AND UNDERSTANDING FOR ITS EFFORTS. ITS ROOM FOR MANEUVER IS BEING PROGRESSIVELY NARROWED AND TIME IS BEGINNING TO GROW SHORT. END SUMMARY

1. THE LABOR PARTY ON JULY 18 FORCED A CENSURE DEBATE ON INFLATION. ZEROING IN ON WHAT IT CLEARLY SEES AS ITS MOST POTENT ELECTORAL ISSUE, LABOR, LED BY HAROLD WILSON, HAMMERED AWAY AT THE GOVERNMENT'S ALLEGED INABILITY TO CONTROL THE RISING PRICE OF FOOD AND OTHER ESSENTIALS, TO MAINTAIN THE VALUE OF THE POUND AT HOME AND ABROAD, AND TO CREATE A FAIR AND JUST SOCIETY. WILSON CHARGED HEATH WITH WINNING THE 1970 GENERAL ELECTION SOLELY ON HIS PROMISE TO CONTROL PRICE RISES -- A PROMISE HE DESCRIBED AS UTTERLY FRAUDULENT AND DECEPTIVE.

2. WILSON CITED RECENT INCREASES IN PRICES (RETAIL PRICE INDEX UP 9.5 PERCENT FROM MAY 1972 TO MAY 1973, WITH FOOD PRICES UP 16.2 PERCENT IN SAME PERIOD) AND THE CONTINUING DEPRECIATION OF THE POUND (FINANCIAL TIMES WEIGHTED AVERAGE SHOWS DEPRECIATION OF ABOUT 17 PERCENT SINCE DECEMBER 1971). WILSON SAID DEVALUATION IS A CONFESSION OF FAILURE OF GOVERNMENT'S POLICY. HE CONSIDERED IT EASY TO ACHIEVE GROWTH AT A TIME WHEN GOVERNMENT IS RUNNING A BUDGET DEFICIT OF OVER FOUR BILLION POUNDS, AND ALSO CITED INCREASING TRADE AND CURRENT ACCOUNT DEFICITS. ACCORDING TO WILSON, THE GOVERNMENT'S ANTI-INFLATION POLICY IS FAVORING PROFITS AT THE EXPENSE OF WAGES.

3. IN REJOINDER, HEATH PLACED MUCH OF THE BLAME FOR RISING PRICES ON WORLD COMMODITY TRENDS. HE REJECTED CHARGES THAT THE RISE IN FOOD PRICES IS PRIMARILY DUE TO ENTRY INTO THE EC. RISE ATTRIBUTABLE TO ENTRY ONLY ONE PERCENT THUS FAR. IT IS NOT FAIR TO BLAME THE FLOATING OF THE POUND OR THE GROWTH OF THE MONEY SUPPLY. HEATH NOTED THAT LABOR PARTY HAD SUPPORTED POLICY OF SUSTAINED EXPANSION OF THE ECONOMY. IN CONSEQUENCE, LIMITED OFFICIAL USE

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THERE WOULD BE DEMANDS MADE ON THE BALANCE OF PAYMENTS; IT WOULD BE NECESSARY TO TAKE MEASURES TO OVERCOME SHORTAGES OF LABOR AND SKILLS AS WELL AS TO PROVIDE SUFFICIENT PROFITS TO COVER INVESTMENT FOR FURTHER EXPANSION. THE GOVERNMENT LOOKS TO CONTINUED EXPANSION, BUT THIS WILL REQUIRE BETTER USE OF ECONOMIC RESOURCES, ESPECIALLY DURING THE COMING 18 MONTHS BEFORE NEW INVESTMENT PROJECTS CAN BE MADE OPERATIONAL. HEATH SAID

ANY PROPOSALS FOR COUNTERING INFLATION WHICH DEALT ONLY WITH PRICES AND WHICH DID NOT DEAL WITH EXCESSIVE WAGE CLAIMS WOULD BE FRAUDULENT.

4. HEATH ALSO TOOK THE OPPORTUNITY TO REVEAL THAT VOLUNTARY THRESHOLD AGREEMENTS, I.E., ESCALATOR CLAUSES -- UNDER WHICH WAGES RISE AUTOMATICALLY WHEN PRICES RISE ABOVE A CERTAIN FIGURE -- WOULD LOOM LARGE IN THE PROPOSALS THE GOVERNMENT WILL PUT TO THE TUC AND THE CBI IN THEIR FORTHCOMING TALKS ON PHASE III. HEATH RULED OUT BLANKET FOOD SUBSIDIES AS LEADING INEVITABLY TO RATIONING AND A STIFF INCREASE IN TAXATION, BUT HE LEFT THE DOOR OPEN TO SELECTIVE FOOD SUBSIDIES, IF NECESSARY.

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RSR-01 /193 W

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FM AMEMBASSY LONDON

TO SECSTATE WASHDC 2804

INFO AMEMBASSY BERN

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5. WINDING UP THE DEBATE, THE CHANCELLOR, TONY BARBER, ANNOUNCED FURTHER SELECTIVE INCREASES IN THE ALLOWANCE FOR RENTS, BEGINNING IN OCTOBER. THIS WILL MORE THAN OFFSET PLANNED RENT INCREASES, HELP THE LOWER PAID, A GOAL THAT THE GOVERNMENT HAS PLACED IN THE CENTER OF ITS ANTI-INFLATION PROGRAM FROM THE START, AND  
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ASSUAGE GROWING BACKBENCH CONSERVATIVE ANXIETY ABOUT THE ELECTORAL IMPACT OF RISING RENTS.

6. CONTINUING, BARBER STATED THAT THE GOVERNMENT'S DETERMINATION TO SPEED UP THE RATE OF ECONOMIC EXPANSION HAS BEEN THE ONLY MEANS BY WHICH THE U.K. -- OR ANY NATION -- COULD IMPROVE ITS PROSPERITY. AS A TRADING NATION IN A SITUATION WHERE WORLD-WIDE INFLATION HAS SPEEDED UP, THE U.K. MUST TAKE SUCH ACTION AS IS AVAILABLE TO IT TO CONTAIN DOMESTIC COSTS AND PRICES, CONSISTENT WITH A POLICY OF SUSTAINED GROWTH.

7. COMMENT: IN DEVISING AN ECONOMIC STRATEGY FOR PHASE III AND BEYOND, THE GOVERNMENT CLEARLY HOPES TO REDUCE THE RATE OF INFLATION, ESPECIALLY IN FOOD PRICES, BEFORE THE NEXT GENERAL ELECTION. FAILING THAT -- AND ASSUMING IT CAN CONVINCE THE ELECTORATE THAT ITS FAILURE IS DUE TO WORLD CONDITIONS BEYOND ANY BRITISH GOVERNMENT'S POWER TO CONTROL -- IT MUST ENSURE THAT THOSE SUFFERING MOST FROM INFLATION (I.E., THE LOWER PAID AND THE PENSIONERS) ARE COMPENSATED FAIRLY WITH INCREASED BENEFITS (E.G., SOCIAL SECURITY, FAMILY ALLOWANCES, PENSIONS).

8. AT THE SAME TIME, THE GOVERNMENT DARE NOT PUT AT RISK ITS LONG-TERM ACHIEVEMENTS ON WHICH IT HOPES TO BASE ITS APPEAL FOR A RENEWED MANDATE (E.G., A SUSTAINED HIGH LEVEL OF ECONOMIC GROWTH, AN IMPROVED EXPORT MARKET, RENEWED MANUFACTURING INVESTMENT, REDUCED UNEMPLOYMENT AND A RESTRUCTURED SYSTEM OF TAXATION). FINALLY, LOOMING OVER THIS DIFFICULT PROBLEM AND THREATENING TO SABOTAGE THE GOVERNMENT'S STRATEGY

ALTOGETHER, ARE THE MASSIVE WAGE DEMANDS BEING READIED  
BY THE STRONGEST AND MOST MILITANT TRADE UNIONS.

9. THE GOVERNMENT'S ROOM FOR MANEUVER ON ECONOMIC  
MATTERS IS BEING PROGRESSIVELY NARROWED. SHORTAGES OF  
LABOR, INCREASED PRESSURE ON INDUSTRIAL CAPACITY, AND A  
GROWING TRADE DEFICIT MAY LEAD TO A SHIFT TOWARDS A  
MORE RESTRICTIVE ECONOMIC POLICY.

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10. IF THE GOVERNMENT IS UNABLE TO ENLIST THE CO-  
OPERATION OF THE TRADE UNIONS IN PHASE III, IT MUST  
THEN BE CERTAIN THAT ITS POLICIES HAVE GAINED SUFFICI-  
ENT POPULAR UNDERSTANDING AND SYMPATHY TO ENABLE IT TO  
TAKE ITS CASE TO THE ELECTORATE WITH CONFIDENCE. THAT  
DEGREE OF POPULAR UNDERSTANDING AND SYMPATHY IS NOT YET  
EVIDENT AND TIME IS BEGINNING TO GROW SHORT.

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